

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

NO PROTEST RECEIVED
Release copies to District

Date 1/5/00

Surname [REDACTED]

Date: NOV 29 1999

Contact Person: 1/4/00

I.D. Number: [REDACTED]

Telephone Number: [REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(4) and concluded that you are not exempt under that section. Because you indicated to us that you believed that you might also qualify for exemption under section 501(c)(6), we also considered whether you are exempt under that section of the Code. We have also concluded that you are not exempt under section 501(c)(6). The basis for our conclusions is set forth below.

FACTS

You were incorporated on [REDACTED] as a nonprofit membership corporation under the laws of [REDACTED]. Your members consist of your Board of Directors. According to your amended Articles of Incorporation, in the event of dissolution, your net assets would be distributed to an organization that is exempt under section 501(c)(3) of the Code.

You operate a network of physicians, hospitals and other health care providers for the benefit of the employees of your client organizations and their dependents. Your revenue is derived from providing these individuals with access to your health care network. Your only client is the [REDACTED] self-insured benefit plan (the "County") covering approximately [REDACTED] beneficiaries. Under your contract with the County (the "Services Agreement"), your responsibilities consist of making available your network of health care providers at specific rates and periodically providing updated panel directories to beneficiaries.

[REDACTED] your Bylaws provides that your Board of Directors is comprised of 14 persons; two hospital representatives, two physicians, four employer representatives, one alternative care provider, your Chief Executive Officer, and four members of the community. Your Board of Directors has adopted a substantial conflicts of interest policy.

You have a contract with [REDACTED] limited liability company, to perform management services for your organization. [REDACTED] is owned by [REDACTED], who serves on your Board as your Executive Director. [REDACTED] provides management services to a number of different clients, including your organization.

Under your contract with [REDACTED], [REDACTED] services include administering your basic business functions, such as representing your organization to other persons and organizations; formulating and proposing capital development plan options to your Board of Directors; and implementing your business and capital development plans. Under this contract, you pay [REDACTED] \$[REDACTED] per month plus a [REDACTED] "Fee" of [REDACTED] percent of capital raised. Effective [REDACTED], the monthly

management fee was reduced to \$ per month.

In 1996, your Board submitted requests for proposals to four health care management organizations, including . However, due to your limited resources, was the only organization that submitted a proposal. Your Board of Directors selected in . At that time, no director had any relationship with .

You have contracts with various primary and specialty health care providers. Under a typical contract, a provider agrees to provide health care services to eligible persons, to submit claims on a timely basis and to accept the fees specified in the contract. Your obligations include maintaining current, accurate information regarding each participating provider's practice and assuring that covered groups have timely access to this information; advising participating providers of each new covered group and related benefit schedules; promoting benefit plans which provide patient incentives to utilize participating providers; and pay or settle properly completed claims within thirty days of receipt.

LAW

Section 501(c)(4)

Section 501(c)(4) of the Code provides for the exemption from federal income taxation of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(a)-1(c) of the Income Tax Regulations defines the words "private shareholder or individual" as persons having a personal and private interest in the activities of the organization. Thus, exemption under section 501(c)(4) of the Code depends on an organization's ability to serve in some manner the general welfare of the community rather than providing benefits primarily to its members or to other interested parties.

Section 1.501(c)(4)-1(a)(1) of the regulations provides that an organization is described in section 501(c)(4) of the Code if (1) it is not organized or operated for profit and (2) it is operated exclusively for the promotion of social welfare. Section 1.501(c)(4)-1(a)(2)(i) of the regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.

Section 1.501(c)(4)-1(a)(2)(ii) of the regulations provides that an organization is not operated primarily for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

In general, social welfare must benefit the general community as a whole and organizations exempt under section 501(c)(4) of the Code must be operated primarily to promote social welfare. Certain social welfare organizations serve only the community as a whole (pure public benefit) while others benefit a particular group of people but still primarily serve community interests. However, in instances where an organization limits its benefits to members, the organization is generally considered not to be operated for social welfare purposes.

A number of rulings illustrate the distinction between organizations that serve the community and those that serve only their members or some other restricted class. See, e.g., Rev. Rul. 78-69, 1978-1 C.B. 156 (providing rush-hour bus service to members of the general public, where the bus service provided is subsidized by government and the regular bus service is not adequate or commercially

available, constitutes a social welfare activity); and Rev. Rul. 78-429, 1978-2 C.B. 178 (an organization primarily promoted social welfare because it met a community need by operating an airport not otherwise available to the rural communities of the area). But see Rev. Rul. 75-199, 1975-1 C.B. 160 (an organization formed to provide sick and death benefits to members who are restricted to individuals of good moral character and health who belong to a particular ethnic group and reside in a stated geographical area provides only minor and incidental benefits to the community as a whole); Rev. Rul. 81-58, 1981-1 C.B. 331 (an organization composed of police officers of a particular community formed primarily to provide a lump-sum payment upon retirement or death primarily benefits its members and only incidentally benefits the community as a whole); Rev. Rul. 86-98, 1986-2 C.B. 74 (an individual practice association [IPA] that provides commercial services to health maintenance organizations [HMOs] primarily benefits its member-physicians rather than the community as a whole); and Rev. Rul. 55-311, 1955-1 C.B. 72 (providing bus service for a local association of employees, the membership of which is limited to employees of a particular corporation, is not a social welfare activity).

The distinction between "pure" public benefit and private benefit is illustrated by comparing Rev. Rul. 54-394, 1954-2 C.B. 131 (an organization does not primarily promote social welfare where it provides television reception on a cooperative basis), with Rev. Rul. 62-167, 1962-2 C.B. 142 (an organization retransmitting TV signals for the benefit of the entire community qualifies as a social welfare organization). See also Rev. Rul. 80-206, 1980-2 C.B. 185 (an organization formed to promote the legal rights of all tenants in a particular community qualifies as a social welfare organization), and Rev. Rul. 73-306, 1973-2 C.B. 179 (a similar organization, formed to protect the rights of tenants in one particular rental complex, was not primarily promoting social welfare).

Another example of an organization benefiting only its members is Rev. Rul. 66-148, 1966-1 C.B. 143, in which the Service held that an organization formed to establish and maintain a system for water storage and distribution was exempt under section 501(c)(4) of the Code. Although it was a membership organization, its activities resulted in an increase in the level of underground water, which benefited the entire community, irrespective of membership.

Therefore, when the services furnished by an organization are beneficial to the community and available to all members of the community on an equal basis irrespective of membership, a social welfare objective will generally be found to exist. However, where an organization limits its services and benefits to its members, the organization is not ordinarily operated exclusively for the promotion of social welfare within the meaning of section 501(c)(4).

While a social welfare organization necessarily benefits private individuals in the process of benefiting the community as a whole, even when the benefits are confined to a particular group of individuals, the organization may be exempt if the general community derives a substantial benefit. Conversely, an organization that benefits a large number of people will not necessarily be organized for social welfare purposes within the meaning of section 501(c)(4) because numbers are not necessarily determinative of social welfare objectives. Social welfare is the wellbeing of persons as a community and classification depends upon the character - as public or private - of the benefits bestowed, of the beneficiary, and of the benefactor. See Commissioner v. Lake Forest, Inc., 305 F.2d 814 (4th Cir. 1962).

Therefore, the issue is whether the organization's activities result in so much private benefit as to preclude it from qualifying as a social welfare organization. The test in resolving this question with respect to exemption under section 501(c)(4) is "primarily," which, as used in the regulations, means that some amount of private benefit may be permissible so long as the organization's activities remain primarily social welfare. This necessarily requires weighing the extent to which an organization's activities are social welfare activities versus those that result in a private benefit. An example of the balancing between public and private benefits is Rev. Rul. 72-102, 1972-1 C.B. 149. In this ruling, a homeowner's association

formed by a developer to administer and enforce covenants for preserving the architecture and appearance of a housing development and to own and maintain common green areas, streets and sidewalks for the use of development residents was held to be exempt under section 501(c)(4) of the Code even though there existed some amount of private benefit to the developer and individual residents because these benefits were incidental to the benefit provided to the community as a whole. Accordingly, exemption under section 501(c)(4) of the Code depends on an organization's ability to serve in some manner the general welfare of the community rather than providing benefits primarily to its members or to other interested parties.

Section 501(c)(6)

Section 501(c)(6) of the Code provides for the exemption from federal income taxation of business leagues and other specified organizations, provided no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the regulations provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. Its activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

In Rev. Rul. 71-175, 1971-1 C.B. 153, a nonprofit organization was composed of medical professionals. Its principal activity was the operation of a telephone-answering service for its member doctors. This organization did not qualify for exemption under section 501(c)(6) of the Code because by providing a telephone-answering service, the organization relieved the individual members of the necessity of securing this service commercially. Thus, the organization rendered particular services for individual persons, as distinguished from improving business conditions in the medical profession and public health area generally. Therefore, this revenue ruling held that the organization did not qualify for exemption under section 501(c)(6) of the Code.

In Rev. Rul. 86-98, *supra*, because the billing and collection services provided an economy or convenience to its members relating to the operation of their private medical practices, the organization was primarily performing particular services for its members. Thus, the organization was rendering particular services for individual persons as distinguished from improving business conditions in the medical profession and public health area generally. The organization did not strive to better conditions for all physicians in a particular community, but, instead, was devoted to maximizing fees for its members.

RATIONALE

Section 501(c)(4)

You have contracted with the County to establish a network of health care providers who have agreed to provide, at predetermined rates, health care services to the County's employees and their dependents. In addition, under your contracts with the health care providers, you process claims and make payments to the providers.

You have not demonstrated that you intend to enroll persons who are generally unable to obtain affordable health care services or health care insurance or who have special health care needs, such as individuals, employer groups consisting of employers having 50 or fewer employees, Medicare beneficiaries, Medicaid beneficiaries or other individuals who have special health care needs, such as persons who are disabled or who suffer from substance abuse. Your only enrollees consist of the

[REDACTED]

County's employees and their dependents. Employees of a local county government are not considered to fall within any of these groups. Further, the services you provide to individual health care providers are services which are generally commercially available. Thus, the beneficiaries of your activities are primarily your members and your contracting providers, rather than the community as a whole, as required in section 1.501(c)(4)-1(a)(2)(i) of the regulations. See Rev. Rul. 75-199, *supra*; Rev. Rul. 81-58, *supra*; Rev. Rul. 86-98, *supra*; and Rev. Rul. 55-311, *supra*. Therefore, you do not qualify for exemption under section 501(c)(4) of the Code because you are not operated exclusively for the promotion of social welfare, as required in section 1.501(c)(4)-1(a)(1)(ii) of the regulations.

Section 501(c)(6)

Your activities include providing various commercial services to your contracting providers. These activities benefit these providers individually rather than improving business conditions in the medical profession and public health area generally. Your activities do not strive to better conditions for all health care providers in the community but provide an economic advantage solely to your contracting providers. See Rev. Rul. 71-175, *supra*; and Rev. Rul. 86-98, *supra*. Therefore, you do not qualify for exemption under section 501(c)(6) of the Code because you are not an association of persons having a common business interest, the purpose of which is to promote such common business interest and because your activities are not directed to the improvement of business conditions in your line of business, as required in section 1.501(c)(6)-1 of the regulations.

CONCLUSION

Accordingly, you do not qualify for recognition of exemption as an organization described in either section 501(c)(4) or section 501(c)(6) of the Code and you must file federal income tax returns.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within thirty (30) days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If we do not hear from you within thirty (30) days, this ruling will become final and a copy will be forwarded to the Ohio EP/EO key district office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, EP/EO Customer Service, P.O. Box 2508, Cincinnati, OH 45201.

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
[REDACTED]
OP:EO:T:1, Room 8514
1111 Constitution Avenue, N.W.
Washington, DC 20224

For your convenience, our FAX number is [REDACTED] and my E-Mail address is:

[REDACTED]@m1.irs.gov

[REDACTED]

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Marvin Friedlander
Marvin Friedlander
Chief, Exempt Organizations
Technical Branch 1